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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 735

GAMBLE-SKOGMO, INC.

Petitioner

vs.

WESTERN AUTO SUPPLY COMPANY AND BENEFICIAL FINANCE CO.

Respondents

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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STATEMENT

The facts essential to the consideration of this petition for writ of certiorari are accurately and succinctly stated in the parties' Stipulation of Facts (R. pp. 60, 62-66) and in the initial portion of the Memorandum Decision of the District Court (R. pp. 164-166). The latter reads, in pertinent part, as follows:

> "As of January 1, 1960, the defendant, Gamble-Skogmo, Inc., was the beneficial owner of 1,256,044 shares of common stock issued by Western Auto Supply Company, a former Missouri corporation hereaft-

er called Western Missouri. From January 1, 1960, to July 11, 1960, these holdings represented more than ten per cent of Western Missouri's only outstanding class of common stock. Prior to January 15, 1960, there was due and owing from Gamble-Skogmo to its Employees Profit Sharing-Stock Bonus Trust Fund, hereafter called the Trust Fund, the sum of $839,-251.78. On January 15, 1960, the Gamble-Skogmo Executive Committee approved the purchase of 32,-000 shares of Western Missouri common stock for the purpose of contributing them, or as much thereof as would be necessary, to the Trust Fund in order to satisfy Gamble-Skogmo's 1959 obligation. On January 21, 1960, Gamble-Skogmo purchased 32,000 shares of Western Missouri common stock at $32.35 per share for $1,035,200 through Allen and Company, an investment securities dealer. On January 27, 1960, Allen and Company delivered to Gamble-Skogmo the required number of share certificates of Western Missouri bearing street names (not designated by Gamble-Skogmo) and endorsed in blank. Following the receipt of the stock, on January 28, 1960, Gamble-Skogmo caused 25,942 shares of this stock to be transferred to a nominee for the corporate trustee of the Trust Fund. In that the stock at the price purchased totaled $839,223.70, and the indebtedness to the Trust Fund was $839,251.78, a check for $28.08 was delivered to the Trust Fund trustee by Gamble-Skogmo so that the total amount due of $839,251.78 was obtained thereby. The remaining 6,058 shares of the 32,000 shares of Western Missouri thus purchased was then transferred to Gamble-Skogmo on the stock records of Western Missouri. It should be mentioned that Gamble-Skogmo was not required to make its contribution to the Trust Fund in Western Missouri stock or any other stock, but it merely chose this method to make this voluntary contribution for the year 1959.

With the 6,058 shares added to the 1,256,044 shares, Gamble-Skogmo owned 1,262,102 shares of Western Missouri stock on January 31, 1960. All of these shares were sold to the Beneficial Finance Co. on July 11, 1960, for a price of $36 per share, totaling $45,435,672. In the interim from January 31, 1960, to July 11, 1960, Gamble-Skogmo had received dividends on its Western Missouri stock totaling 70 cents per share. The stipulation of facts states that on July 28, 1961, Beneficial and Western Missouri agreed to merge into the former company. The merger was completed on October 27, 1961. On the same date, Beneficial sold all its right, title and interest in Western Missouri assets to Western Auto Supply Company, a Delaware corporation, hereafter referred to as Western Delaware."

The relevant facts set forth in the Stipulation of Facts are fairly summarized in the foregoing statement of the District Court. Both decisions below rested squarely on these facts and no others are necessary to the disposition of this petition.

ARGUMENT

The correct resolution of the issues presented to the courts below in this case turned solely on the stipulated facts. The law applicable to those facts is settled and routine. The decision of the Court of Appeals for the Eighth Circuit adheres precisely to the rules of statutory interpretation of Section 16(b) established by the leading cases under that provision, whereas the decision of the District Court constituted a deviation from those rules. Moreover, the Eighth Circuit decision lends support to the policy of the statute, while the decision of the District Court threat-

ened seriously to undermine it. In short, there is no justification for review of the Eighth Circuit decision by this Court.

I.

All Requisites for Liability under Section 16(b) Are Here Present

There are five, and only five, elements relevant to a determination of liability under Section 16(b): (1) a purchase, and (2) a sale, (3) of an equity security (other than an exempted security), (4) within a period of less than six months, (5) by a 10% beneficial owner. When these five elements have been established, the profit realized on the purchase and sale is the measure of recovery.

The petition for writ of certiorari disputes the correctness of the finding of liability below primarily on the grounds that a "purchase" and a "sale" within the meaning of Section 16(b) were not established. Its principal support for this statement appears to be Judge Nordbye's characterization of the transaction as one in which the shares which passed into the Trust Fund "were simply handled by Gamble-Skogmo as a conduit" (R. p. 173), which statement it characterizes as a finding of fact (Petition p. 8).

The fallacy in this line of reasoning is, of course, that Judge Nordbye's characterization of Gamble-Skogmo as a "conduit" cannot be considered a finding of fact. It is nothing more than the expression of a conclusion, which, as the Securities and Exchange Commission stated in its amicus brief in the Court of Appeals, "appears to be without support in the record" (Petition pp. 9, A-18 n. 1). Given the stipulated facts, Gamble-Skogmo can only be called a "conduit" in the simple, descriptive sense that it was an

entity through whose hands the shares passed. In this sense, the "conduit" concept is of no utility in determining whether a "purchase" and a "sale" occurred.

That a "purchase" and a "sale" actually did occur is conclusively established by the Stipulation of Facts of the parties (R. pp. 60, 62-66) as summarized in the District Court's Memorandum Decision, quoted at length in the Statement, *supra*. As the District Court found, on January 21, 1960, Gamble-Skogmo "purchased" 32,000 shares of Western Missouri common stock. On July 11, 1960, Gamble-Skogmo "sold" 1,262,102 shares of Western Missouri common stock to Beneficial Finance Co. These facts alone suffice to establish an unlawful purchase and sale within a period of six months.

Petitioner's sole argument to the contrary derives from the fact that Gamble-Skogmo caused 25,942 of the 32,000 recently purchased shares to be transferred, upon receipt, to the Trust Fund. Petitioner's theory apparently is that these 25,942 shares were purchased only for the Trust Fund and were therefore not among the shares sold in July. But this argument requires resort to the thoroughly discredited theory that a finding of violation of the statute depends upon a finding of a purchase and a sale of identical shares within six months. The ascertainment of the particular shares bought and sold is wholly irrelevant. Rather, Section 16(b) is satisfied only by a comparison of the lowest purchase price and the highest sale price at which *any* of the group of shares in question were bought and sold during any period of less than six months. See, *e.g., Gratz v. Claughton*, 187 F. 2d 46 (2d Cir.), *cert. den.*, 341 U. S. 920 (1951); *Smolowe v. Delendo Corp.*, 136 F. 2d 231 (2d Cir.), *cert. den.*, 320 U. S. 751 (1943); *Heli-*

Coil Corp. v. Webster, 222 F. Supp. 831 (D.N.J. 1963); *Steinberg v. Sharpe,* 95 F. Supp. 32 (S.D.N.Y. 1950), *aff'd on opinion below,* 190 F. 2d 82 (2d Cir. 1951); 2 Loss, SECURITIES REGULATION 1063 (2d ed. 1961). Since shares of stock are fungible, a 10% beneficial owner is not entitled to match share certificates to determine whether a profit has been realized under the terms of Section 16(b). See, *e.g., Walet v. Jefferson Lake Sulphur Co.,* 202 F. 2d 433 (5th Cir.), *cert. den.* 346 U. S. 820 (1953); Cook & Feldman, *Insider Trading Under the Securities Exchange Act,* 66 HARV. L. REV. 612, 613 (1953); Rubin & Feldman, *Statutory Inhibitions Upon Unfair Use of Corporate Information by Insiders,* 95 U. PA. L. REV. 468, 481 (1947).

Alternatively, petitioner may be arguing that Gamble-Skogmo never really purchased or sold the Western Missouri shares because it acquired them only as agent for the Trust Fund. But this simply was not the fact. As the District Court stated, "It should be mentioned that Gamble-Skogmo was not required to make its contribution to the Trust Fund in Western Missouri stock or any other stock, but it merely chose this method to make this voluntary contribution for the year 1959" (R. p. 165). Gamble-Skogmo alone made the decision to satisfy its obligation by contributing newly purchased shares rather than cash or shares which it already owned. The Trust Fund exercised no direction or control whatever over the process of acquisition and contribution.

Respondents emphasize that they do not here contend that a profit was realized by petitioner on the purchase and transfer to the Trust Fund. The profit which respondents are entitled to recover is measurable by the difference between the January 21, 1960, purchase and the July 11,

1960, sale. Contrary to petitioner's argument, petitioner not only realized this profit within the meaning of Section 16 (b), *but did in fact profit from the transactions here under consideration.* If petitioner had contributed 25,942 Western Missouri shares to the Trust Fund without first purchasing additional shares, it would have owned 25,942 fewer shares on July 11, 1960, and would have received a correspondingly smaller profit on the sale on that date. Thus, the profit here ascribed to Gamble-Skogmo was a profit *in fact* as well as a profit in theory.

Under the facts of the case, Gamble-Skogmo purchased Western Missouri common stock on January 21, 1960, at $3.65 per share less than the price at which it sold Western Missouri common stock on July 11, 1960. Thus, a short-swing profit was realized. It is clear that the merits of the case were correctly decided by the Court of Appeals, and the Securities and Exchange Commission concurs in this conclusion (see Petition p. 8).

II.

There Is No Conflict with Other Decisions

Petitioner strives mightily to develop the theory that there is some sort of conflict between the decision of the Court of Appeals on the one hand and decisions of this Court and other federal courts on the other. In fact, no such conflict exists, and petitioner has pointed to none.

Petitioner relies, first, on two decisions of this Court, *United Gas Improvement Co. v. Continental Oil Co.,* 14 L. Ed. 2d 466 (1965), and *Blau v. Lehman,* 368 U. S. 403 (1962). The former case deals with the Natural Gas Act, and has nothing whatever to do with Section 16(b) of the Securities Exchange Act of 1934. And, while the

Blau decision did arise under Section 16(b), it had nothing whatever to do with the interpretation of the terms "purchase" and "sale." In *Blau* the question was whether a defendant partnership was or was not an "insider" subject to the sanctions of Section 16(b)—a question obviously unlike and unrelated to any issue presented here. Moreover, the argument for liability advanced in *Blau* was demonstrably rejected by the Congress at the time of enactment of the statute; no such consideration is applicable to the present case.

Petitioner contends that the *Blau* case somehow supports the thesis that no "profit" was "realized" by it due to the transfer of shares to the Trust Fund. The fallacy of this argument is that it distorts *Blau* into a precedent for matching the purchase and sale of identical share certificates in determining liability under Section 16(b). Of course, *Blau* stands for no such principle. It is immaterial that Gamble-Skogmo did not have in its possession at the time of its July 11, 1960, sale the specific stock certificates representing 25,942 of the shares it purchased on January 21, 1960, for liability follows as a necessary consequence of the fact that Gamble-Skogmo purchased Western Missouri common shares on January 21, 1960, and sold Western Missouri common shares at a higher price on July 11, 1960. See, *e.g., Gratz v. Claughton, supra; Smolowe v. Delendo Corp., supra.*

Nor does any of petitioner's references to cases in lower federal courts (Petition p. 12) point to any conflict with the decision below. All of those cases (save *Blau v. Lehman, supra,* already discussed) deal with the problem of conversion of one class of security into another, a problem not in issue here. Petitioner erroneously argues that the de-

cision of the Court of Appeals is in conflict with the prevailing standards of interpretation of Section 16(b). In fact, all that the Court of Appeals did was to apply the prevailing standard under Section 16(b), *viz.*, the lowest-in, highest-out technique for measuring insider profit on a purchase and sale of securities of the same class. Any other approach would have revolutionized and subverted administration of the statute.

With respect to the recovery of dividends on the Western Missouri stock, petitioner contends that plaintiff's recovery creates "constitutional problems of due process" (Petition p. 18). However, no authority is offered in support of this proposition. All four judges who considered this case below agreed that plaintiff was entitled to recover dividends. No element of the question merits review by this Court.

III.

The Decision Below Supports the Policy of the Statute

Contrary to petitioner's argument, it is patently clear that the decision of the Court of Appeals supports the policy of the Statute. Indeed, if the decision of the District Court had remained law, enforcement of Section 16(b) would have been gravely jeopardized.

It is apparent at the outset, both from the express language of the statute and from its purpose, that petitioner Gamble-Skogmo's intention in purchasing and selling the stock is irrelevant. Because of the difficulty inherent in proving the intention or motive of a 10% beneficial owner, the statute was designed to hold such a beneficial owner liable "irrespective of any intention or expectation to sell the security within six months." See Hearings Before the Committee on Banking and Currency on S. Res. 84, 72d

Cong., 2d Sess., and S. Res. 56 and S. Res. 97, 73d Cong., 1st and 2d Sess. 1934, 6557, See, *e.g.*, *Smolowe v. Delendo Corp.*, *supra*, 136 F. 2d, at 235; *Stella v. Graham-Paige Motors Corp.*, 132 F. Supp. 100, 102 (S.D.N.Y. 1955), *cause remanded*, 232 F. 2d 299 (2d Cir. 1956), *cert. den.*, 352 U. S. 831 (1956); *Carr-Consolidated Biscuit Co. v. Moore*, 125 F. Supp. 423, 427 (M.D. Pa. 1954); Yourd, *Trading in Securities by Directors, Officers and Stockholders: Section 16 of the Securities Exchange Act*, 38 MICH. L. REV. 133 (1939). Similarly, the fact that the purchase and sale were transacted in good faith and without any actual inside information can be no defense. See, *e.g.*, *Walet v. Jefferson Lake Sulphur Co.*, *supra*; *Smolowe v. Delendo Corp.*, *supra*; *Arkansas Louisiana Gas Co. v. W. R. Stephens Investment Co.*, 141 F. Supp. 841 (W.D. Ark. 1956).

As we have shown, the Court of Appeals did no more and no less in this case than apply the lowest-price-in, highest-price-out standard in determining the amount of profit realized by petitioner. No other approach was permissible, because this is the only formula which, when consistently applied, will prevent *all* short-term profits and, hence, effectuate the remedial purpose of the statute. "We must suppose that the statute was intended to be thoroughgoing, to squeeze all possible profits out of stock transactions, and thus to establish a standard so high as to prevent any conflict between the selfish interest of a fiduciary officer, director, or stockholder and the faithful performance of his duty." *Smolowe v. Delendo Corp.*, *supra*, 136 F. 2d, at 239. The single formula which assures the recovery of all possible profits is that of lowest-price-in, highest-price-out, within six months, irrespective of the identity of the securities involved. *Ibid.* And see *Gratz v. Claughton*, *supra*, 187 F. 2d, at 51-52.

The District Court refused to abide by this rule and, in permitting its determination to turn upon the identification of stock certificates, it ignored the underlying policy which prompted the adoption of the recognized formula. The application of the formula cannot be made dependent upon a preliminary, subjective determination of whether the insider has attempted to avoid the impact of the statute, or whether there is a danger of its evasion. So indefinite an approach undermines the Congressional purpose to bypass the question of the insider's blameworthiness in each case in favor of a clear-cut rule that will categorically prevent such evasion.

If the approach of the District Court were to prevail, an appearance of honesty and sincerity would permit a 10% beneficial owner easily to avoid the impact of Section 16(b) by holding any given stock certificate for more than six months while dealing with other stock certificates within a six-month period, all in reliance on inside information. See, *e.g.*, *Gratz v. Claughton, supra,* 187 F. 2d, at 50-51. Similarly, it could insulate from liability a seemingly upstanding 10% beneficial owner who purchases stock, gives it to his son, and, within less than six months after that purchase, sells the remainder of his entire holdings of that stock at a price greater than what he paid for the shares given his son. Or, such a 10% beneficial owner could, without liability, purchase a block of shares, sell those same shares at cost shortly thereafter, and, within six months of the purchase, sell his remaining shares at a higher price. It is obvious, therefore, that acceptance of petitioner's argument and the conclusions of the District Court would open the door to wholesale circumvention of the statute.

The District Court seems to have veered from the set-

tled course of the law out of apprehension that a finding of liability would lead to a harsh result in this case. But that result is not one iota more harsh than the Congress intended in enacting this statute. The result in this case is, as we have shown, demonstrably related to a genuine profit. By contrast, in *Gratz v. Claughton, supra,* the court affirmed a judgment of $300,000 against the insider-defendant although he suffered an actual net loss of over $400,000 on trading in the stock for which he was charged under Section 16(b). See *Adler v. Klawans,* 267 F. 2d 840, 847-48 (2d Cir. 1959); 2 Loss, SECURITIES REGULATION 1963-64 (2d ed. 1961). As Judge Hand pointed out in that case, such "crushing liabilities" should "certainly serve as a warning, and may prove a deterrent" (187 F. 2d, at 52). To warn and deter, are, of course, the very objects of the statute's existence.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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